Internal Revenue Service

memorandum

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Brl:JCAlbro

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to: District Counsel, Phoenix CC:PNX

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [redacted]
ACRS Gains or Losses on Mass Asset Dispositions

This is in response to your request for "technical advice" dated October 16, 1990. Given that Service position as set forth in Prop. Treas. Reg. § 1.168-2(h)(1) is clear, we assume that you are requesting our advice with respect to the litigation hazards associated with following the proposed regulation.

ISSUE

Whether the Service should follow its position in proposed regulations that proceeds from dispositions of assets from mass asset accounts are included as ordinary income in light of the existing litigation hazards. No. 0168-0800.

CONCLUSION

The litigation hazards for disallowing mass asset gains or losses are substantial. In light of the statute, regulations, legislative history and case law, we believe that taxpayer has credible arguments that such gains or losses are allowable. We recently coordinated this issue with Technical, and they agree that our litigation hazards in following the proposed regulations are substantial.

FACTS

During the years involved, [redacted] retired ACRS properties which were minor value assets. Taxpayer prepared a schedule computing the total basis retired, the accumulated depreciation, the amount of salvage realized and then recognized I.R.C. § 1231 gains or losses as a result of these retirements. It is undisputed that taxpayer did not make an election pursuant to section 168(d)(2)(A).

The examining agent has determined that the taxpayer's assets which are accounted for in the mass asset accounts and depreciated under ACRS should not be removed from the account

and that gain or loss should not be computed on disposition or retirement. He has proposed that the salvage or proceeds realized from the dispositions should be recognized as ordinary income and that no gain or loss should be recognized upon retirement. He has also proposed that the retired assets remain in the mass asset accounts; therefore, the depreciation deductions would remain unaffected.

DISCUSSION

We concur with your opinion, under the facts of this case, both that the taxpayer was using mass asset accounts, and that the fact that separate identification of the assets may be possible does not preclude the use of such accounts.

I.R.C. § 168(d)(2)(A) provides that "in lieu of recognizing gain or loss under this chapter, a taxpayer who maintains one or more mass asset accounts of recovery property may, under Regulations prescribed by the Secretary, elect to include in income all proceeds realized on the disposition of such property." Prop. Treas. Reg. § 1.168-5(e) sets out the manner of making the election. Prop. Treas. Reg. § 1.168-2(h)(1) provides that a "taxpayer may elect to account for mass assets...in the same mass asset account, as though such assets were a single asset...if such treatment is elected, the taxpayer, upon disposition of an asset in the account, shall include as ordinary income...all proceeds realized to the extent of the unadjusted basis in the account...." Temporary regulations were issued in 1981 and Temp. Reg. § 5c.0(a)(1) refers to the section 168(d)(2)(A) election as "inclusion in income of proceeds of disposition." In summary, a mass asset election is not provided for in the Code or the temporary regulations. The mass asset election in the proposed regulations is not legally binding on taxpayers. There is also no requirement for a mass asset accounting election in the ITC regulations. Furthermore, under pre-ACRS regulations, taxpayers were allowed to claim losses from mass asset accounts by using mortality dispersion tables. Treas. Reg. § 1.167-11(d)(3)(v)(d).

The basic issue, of course, involves a conflict between one reasonable interpretation of the statute and Service position as set forth in the proposed regulations. Proposed regulations make ordinary income recognition mandatory once a taxpayer uses mass asset accounting; whereas, the ordinary income recognition requirement is arguably an election in one way of interpreting the statute. The proposed regulations take the position that taxpayers cannot use mass asset accounting and take gains or losses. We believe that such a position has substantial litigation hazards. We would have to convince a court that losses cannot be claimed on disposition of mass assets under ACRS while, for the years at issue, neither the statute nor the

legislative history explicitly supports such a position. See, e.g., S. Rep. No. 97-144, 97th Cong., 1st Sess. 52(1981) (a special rule is provided to avoid calculation of gain on the disposition of assets from mass asset accounts.)

As you stated, there is an apparent conflict between the language of section 168(d)(2)(A), which provides an exception or elective choice to recognizing gains and losses, and the proposed regulations, which make ordinary income recognition mandatory for dispositions from mass asset accounts. Our opinion is that pursuant to the statute and the temporary regulations, it is arguable that the required election is the inclusion of dispositions in income rather than the use of mass asset accounts.

Our hazards in defending the proposed regulations are great because courts give little weight to proposed regulations. See, e.g., Laglia v. Commissioner, 88 T.C. 894, 897(1987), AOD CC-1987-019 (Acq. in Result Only); Zinniel v. Commissioner, 89 T.C. 357, 369 (1987) (Proposed regulations are merely suggestions made for comment and do not have the force of law.) In addition, the Service recently lost a Tax Court case involving the short taxable year provisions of section 168. The court stated that the proposed regulations, upon which respondent relied, carry no more weight than a position advanced on brief. McKnight v. Commissioner, T.C. Memo. 1990-69.

The Tax Reform Act of 1986 changed the mass asset provisions. Pursuant to new Code section 168(i)(4), if a taxpayer has elected to treat all of the assets of a general asset account as if they were a single asset, all proceeds on any disposition of property in a general asset account shall be included in income as ordinary income. The Senate Finance Committee Report, S. Rep. 99-313, 99th Cong., 2d Sess. 104(1986), regarding TRA 1986, discusses present law and states that the full amount of the proceeds realized on disposition of property from a mass asset account are to be treated as ordinary income. See also Joint Committee on Taxation Staff, General Explanation of the Tax Reform Act of 1986, 99th Cong., 2d Sess. at 108 (1987). It appears, though, that the reports are referring to the proposed regulations in discussing "present law" because the mass asset election provisions referred to are only defined in proposed regulations. The reports characterize the treatment of mass asset dispositions under MACRS as a continuation of present law. Yet, there is a material change in the language of the statute; the new language states that dispositions from general asset accounts (called mass asset accounts pre-TRA 1986) result in ordinary income and clearly provides that the election is an election to treat assets in a general asset account as though they were a single asset. Thus, the new statutory language follows the rule set out in the proposed regulations and provides the argument for taxpayers

that the rule was different under the previous statutory language.

Private Letter Ruling 87-21-016 (Feb. 17, 1987), referred to in your request for advice, is primarily concerned with whether the assets at issue qualify as mass assets, but point number six in the letter is relevant to the instant issue. However, it could be challenged in two respects. First, it states that taxpayer must make a mass asset election in accordance with Temp. Reg. §§ 5c.0(a)(2)(i) and (a)(3). The section 168(d)(2)(A) election referred to in these sections of the temporary regulations is described as "inclusion in income of entire proceeds of disposition." The implication that a mass asset election is required pursuant to these provisions is incorrect. Point six also states "as provided by section 168(d)(2)(A) of the Code, taxpayer must include in income all proceeds realized on the disposition of items included in a mass asset account." This is a misquote of the statute which actually states that "in lieu of recognizing gain or loss under this chapter, a taxpayer who maintains one or more mass asset accounts of recovery property may, under Regulations prescribed by the Secretary, elect (emphasis added) to include in income all proceeds realized on the disposition of such property."

We have coordinated with Technical, and they agree with our analysis of the litigating hazards. They further noted that they believe the statute was rewritten because of the pre-1986 ambiguity. They also offered several suggestions on evaluating how taxpayers are using mass asset accounts.

First, taxpayers may not include property placed in service in different years in the same mass asset account. The Service has always required mass asset accounts to be vintage accounts, not open-ended accounts. A similar issue to explore is whether depreciation deductions have been claimed on property placed in service and disposed of in the same year. Section 168(h)(2)(B) disallows a depreciation deduction in the year in which property is disposed.

Technical also suggests evaluating whether taxpayer computed ITC recapture correctly, and whether taxpayer's depreciation deductions under its mass asset accounts were different than those allowed under section 168(b) which provides, "except as otherwise provided in this section, the amount of the deduction allowable... for any taxable year... shall be... determined in accordance with the following table...."

If you have any further questions, please contact Joyce C. Albro at 566-3442.

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